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FRS 102 - The Tax Implications

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BACKGROUND

The requirement to prepare accounts under FRS 102 may give rise to unexpected tax consequences. The move could result in one off adjustments to taxable profits and also have an impact going forward.

ONE OFF TRANSITIONAL ADJUSTMENTS

The change in accounting practice may give rise to transitional accounting adjustments. Depending on the nature of the adjustments, they may be taxed in full in the first year of change, spread over 10 years or not taxed at all.

LONGER TERM CONSEQUENCES

Unless there is a specific rule to the contrary, the taxable profits of a company are based on the accounting profits calculated in accordance with generally accepted accounting practice. The change to FRS 102 may result in some profits or losses being brought into account for the first time, being measured in a different way or recognised in different accounting period.

COMMON ISSUES

AMORTISATION OF GOODWILL AND OTHER INTANGIBLES

In general, for goodwill acquired prior to 9 July 2015 and for acquisitions of other intangible assets, tax relief for amortisation and impairment charges follow the accounting treatment. For acquisitions of goodwill from 9 July 2015, no tax relief is available other than on disposal.

Unlike old UK GAAP, FRS 102 does not permit an intangible asset to have an indefinite useful life. It also sets a limit of 5 years (10 years from 1 January 2016) where a reliable estimate of the useful life cannot be made. An adjustment to the useful life of an intangible asset will give rise to a change in the amount of amortisation charged to the profit and loss account and potentially the timing of tax relief available.

LEASES

FRS 102 requires an operating lease incentive (eg a rent free period) to be spread over the term of the lease. Old UK GAAP required an incentive to be spread over the period ending on the date from which it was expected that the prevailing market rent would be payable (generally the first rent review date). This change could

alter the timing of the recognition of the incentive for both accounting and tax purposes. This will affect both lessees and lessors.

FINANCIAL INSTRUMENTS

Under FRS 102, many financial instruments must be carried at fair value rather than amortised cost. There are also some financial instruments that were not recognised at all under old UK GAAP but must now be carried at fair value in the balance sheet. Changes in fair value (both increases and decreases) will generally be recognised in both the accounts and in the tax return, potentially giving rise to taxable profits or relievable losses on unrealised assets or liabilities.

For certain transitional adjustments arising from derivatives, it may be possible to spread the adjustment for tax purposes over 10 years. There are also circumstances where transitional adjustments would result in double taxation, in which case any adjustment would not be taxed at all. There are also rules which allow a company to disregard certain fair value adjustments for tax purposes in respect of derivatives used for hedging. These rules are designed to reduce the volatility in terms of tax that could arise from fair value accounting.

EMPLOYEE BENEFITS

FRS 102 specifically requires an entity to provide for unpaid holiday pay that has accrued at the balance sheet date. Under old UK GAAP, most companies did not make such provisions and so the new accounting practice could give rise to a transitional adjustment. For tax purposes, the charge arising from the provision is generally only allowable in the accounting period in which it arises if it paid within 9 months of the end of the accounting period.

HMRC GUIDANCE

HMRC have updated their overview paper on FRS 102 which provides a comparison between ongoing and transitional accounting tax differences between Old UK GAAP and FRS 102. It can be downloaded at: www.gov.uk/government/publications/accounting-standards-the-uk-tax-implications-of-new-uk-gaap.

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